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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 275

ESTATE OF FLOYD B. FAULKERSON, DECEASED,
BERNIECE E. FAULKERSON, ADMINISTRATRIX,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. _____

ESTATE OF FLOYD B. FAULKERSON, DECEASED,
BERNIECE E. FAULKERSON, ADMINISTRATRIX,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit, affirming the decision and judgment of the United States District Court for the Northern District of Indiana, Fort Wayne Division, in favor of the defendant after trial.

OPINIONS BELOW.

The opinion of the United States District Court for the Northern District of Indiana, Fort Wayne Division, a copy of which is printed in Appendix A, is reported at 193 F. Supp. 410. The opinion of the United States Court of

Appeals for the Seventh Circuit, a copy of which is printed in Appendix B, is reported at 301 F. 2d 231.

JURISDICTION OF THIS COURT.

The judgment of the District Court was dated and entered March 29, 1961. The judgment of the Court of Appeals was dated and entered March 28, 1962. The order of the United States Court of Appeals for the Seventh Circuit, denying a petition for rehearing was dated and entered April 26, 1962.

The statutory provision conferring jurisdiction on this Court to review the judgment and decision in question is 28 U. S. C. A. 1254 (1).

QUESTION PRESENTED.

Is a final state probate court decision determining property rights of parties, with the court having jurisdiction of the property and the parties, entitled to binding effect in a federal tax case on the precise subject which is at issue in the tax proceeding when the proceedings in the state court were nonadversary in the sense that the parties, having adverse property interests, with notice of the state court proceedings to determine property rights, did not appear to contest the determination?

STATEMENT OF THE CASE.

Floyd B. Faulkerson died on December 27, 1954, and at the time of his death, was a resident of Steuben County, State of Indiana. Decedent died testate and the Will was probated in the Steuben County Circuit Court and a decree was entered awarding the entire estate to the widow. This decree was a final decree of the Steuben County Circuit Court and had never been appealed nor reopened. Berniece E. Faulkerson, surviving wife of Floyd B. Faulkerson,

decedent, was appointed Administratrix with the Will Annexed of the Estate of Floyd B. Faulkerson, Deceased. The Administratrix, when the federal estate tax was paid, claimed, as a marital deduction, one-half the value of the "adjusted gross estate." This claim was disallowed by the defendant through its Commissioner of Internal Revenue and a deficiency was assessed and paid by the Administratrix in the amount of $22,972.44. The Administratrix sought a refund of this amount plus interest after her claim for refund had been rejected by the Commissioner.

By the provisions of decedent's Will, the widow was to have the use, income, rents and profits of the entire estate for and during her life. Subject to the widow's interest, all the rest and residue of the decedent's estate after the death of the widow was devised and bequeathed to the Lincoln National Bank and Trust Company of Fort Wayne, Indiana, to be held in trust by it for the use and benefit of Robert and Elizabeth Faulkerson, their children, until they shall attain the age of thirty-five years. The final clause of the Will gave all the rest, residue and remainder of the estate to the widow. On the date of death of decedent, his wife, Berniece E. Faulkerson, was living and their two children, Robert and Elizabeth Faulkerson, were each thirty-nine years of age. Decedent's children, Robert and Elizabeth Faulkerson, had notice of the proceedings before the Steuben County Circuit Court upon the Administratrix' petition to allow distribution of the entire net estate to the widow, Berniece E. Faulkerson, but neither child appeared in said proceeding to contest said proposed distribution, nor offered any objection to this proposed distribution.

JURISDICTION OF THE COURT OF FIRST INSTANCE.

The jurisdiction of the court of first instance lies under 28 U. S. C. A. Section 1346 (a) (1). This suit was commenced by the plaintiff, a resident of Angola in the State of Indiana, against the defendant United States of America, for refund of federal estate taxes erroneously assessed and wrongfully collected under the Internal Revenue Laws of the United States, after demand for refund was refused by the Commissioner of Internal Revenue.

ARGUMENT

The opinion of the United States District Court for the Northern District of Indiana stated in discussing the binding effect on it of the decree of the Steuben County Probate Court that there is a definite split of authority among the Circuit Courts of Appeals on this point (Appendix A). This judgment of the district court was later affirmed by the United States Court of Appeals for the Seventh Circuit (Appendix B). The opinion of the district court further stated that support for the petitioner's position is found in the 1st, 3rd, and 6th Circuits. The district court in its opinion stated that the case of *Gallagher* v. *Smith*, 223 F. 2d 218 (3rd Circuit, 1955) supported petitioner's position. The said case held that state court decisions determining property rights of parties, which were not obtained by collusion for the purpose of defeating tax liability, are entitled to binding effect in federal tax cases even though the proceedings were nonadversary in the sense that there was no litigation in the state court action. Therefore, there is present a finding by the district court in the case at bar that there was no collusion for the purpose of defeating tax liability. The district court held that an adversary proceeding is an essential requirement for conclusiveness of a state court judgment. With this interpretation the United States Court of Appeals for the Seventh Circuit agreed by its affirmance of the judgment. However, in its opinion the Court of Appeals further states that the state court decree in the case at bar was obtained in a proceeding that was collusive in the sense that a decision was sought which would adversely affect the Government's right to additional estate tax. This statement is merely gratuitous and not relevant to any determination

by the Court, since it based its affirmance of the judgment on the fact that the state court decree was entered in an undefended and nonadversary proceeding and was not binding on the federal court. Both the district court and the Court of Appeals in the case at bar relied on the case of *Brainard* v. *Commissioner of Internal Revenue*, 91 F. 2d 880 (7th Circuit, 1937) as determinative of the question involved. The opinions of both the district court and the Court of Appeals in this case certainly support the proposition that an adversary proceeding in the state court is essential in order for the state court decree to be binding in federal tax litigation. Since the United States Court of Appeals for the Seventh Circuit, by its affirmance of the district court's judgment that an adversary proceeding was essential in the case at bar for conclusiveness of the state court decree, has rendered a decision in conflict with the decision of the United States Court of Appeals for the Third Circuit on the same matter as set forth in the case of *Gallagher* v. *Smith*, 223 F. 2d 218, a review on writ of certiorari is here most respectfully sought.

The opinion of the Court of Appeals stated that the decree of the Steuben Circuit Court was rendered in an *ex parte*, nonadversary proceeding, without a hearing on the merits. The decree that the plaintiff relied upon in this matter was the decree of final distribution and not any intermediate decree. This final decree was not *ex parte*, because it was entered pursuant to notice which fact the record clearly shows (Appellant's Appdx., p. 17). The proceeding may not have been involved with adversary parties in the sense that the case was litigated and contested in the Steuben Circuit Court but there were certainly adversary parties and proceedings involved in the sense of the property interests of the parties being affected. To say that the decree was rendered without a hearing on the merits is to give effect to form and not to substance.

One of the basic tenets of "a passing on the merits" is that the subject matter at issue in the state court proceeding must be, in whole or in part, that which is at issue in the tax proceeding. Mertens Law of Federal Gift and Estate Taxation, Vol. 1, Sec. 10.14, p. 641. The Steuben Circuit Court did have jurisdiction over the parties and subject matter. The state court final decree was final and conclusive under state law on the parties as to the nature and extent of the property rights which were the subject matter of the proceeding. There was an adjudication here by the state court of property matters and a Will construction in a probate proceeding which was instituted solely for that purpose. The subject matter at issue in the state court proceeding was the same that was at issue in the tax proceedings; namely, what the nature was of the interest in the property which passed from the decedent to his surviving spouse by bequest or devise.

The opinion of the Court of Appeals overlooks the nature of the state court probate proceeding. A probate proceeding is one *in rem* and if the statutory provisions regarding constructive service and notice are observed it is binding upon all persons in the world. *In re Broderick's Will*, 21 Wall. 503, 88 U. S. 503, 509, 519, 22 L. E. 599; Burns Indiana Statutes, Annotated, Sec. 7-102.

The opinion of the Court of Appeals stated that the decree was obtained in a proceeding that was collusive in the sense that a decision was sought which would adversely affect the Government's right to additional estate tax. This may be a valid statement in a nonadversary proceeding when no real issue of property rights is involved or when no real issue existing independently of a tax problem is involved, where it can be said that the proceedings might be considered collusive in that the litigation was prompted pre-eminently by tax purposes. However, the property rights of all the parties were involved in the

case at bar and the fact of a nonadversary proceeding in the sense of no litigation occurring should not be determinative in this situation that collusion in the tax sense was present.

Although the effect of nonadversity cannot be regarded as yet as free from controversy, an analysis of the cases supports a statement of the rule which treats the consent nature of a decree, or the nonadversary character of the proceeding, or the resulting lack of any extended consideration of the merits as factors which are relevant in the determination of whether there was a "passing on the merits" but not as in and of themselves determinative of the acceptability of the state court decision.

There is a "passing on the merits" if the subject matter at issue in the state court proceeding is that which is at issue in the tax proceeding and it involves a real issue of property rights.

The decision below departed so far from the accepted and usual course of judicial proceedings of a court as to call for a review of the decision when it refused to consider the record evidence that the decree was not rendered in an *ex parte* proceeding, when it added in its opinion that the decree was collusive in the tax sense from the fact of a nonadversary proceeding alone, and when it added in its opinion that the decree was rendered without a hearing on the merits when the subject matter at issue in the state court proceeding was that which was at issue in the tax proceeding and it involved a real issue of property rights. These matters were specifically called to the court's attention in the Petition for Rehearing.

CONCLUSION.

For the foregoing reasons this petition for a writ of certiorari should be granted.

Dated: July 23, 1962.

Respectfully submitted,

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APPENDIX A.

IN THE UNITED STATES DISTRICT COURT.

(Caption—1183)

ORDER.

This is a suit to recover Estate taxes paid on behalf of the Estate of Floyd B. Faulkerson in the amount of $22,972.44.

The facts, briefly stated, are as follows:

Floyd B. Faulkerson died testate on December 27, 1954. By the provisions of his Will, his wife was to have the use, income, rents and profits of the entire estate for and during her life and upon her death, Robert and Elizabeth Faulkerson, their son and daughter, respectively, were to take the remainder interest, subject to a trust that was to terminate upon their attaining the age of 35 years. The final clause of the Will gave all the rest, residue and remainder of the estate to decedent's wife.

This Will was probated in the Steuben County Circuit Court and a decree was entered awarding the entire estate to the widow.

When the Estate tax was paid the Administratrix claimed, as a marital deduction, one-half the value of the "adjusted gross estate." This claim was disallowed by the Commissioner of Internal Revenue and a deficiency was assessed and paid in the amount of $22,972.44. In this action plaintiff seeks a refund of this amount, plus interest.

It is the contention of the plaintiff that the decree of the Steuben Circuit Court is binding on this Court and

has conclusively determined the right of the plaintiff to the marital deduction. There is a definite split of authority among the Circuits on this point.

Support for the plaintiff's position is found in *Gallagher* v. *Smith*, 223 F. 2d 218 (3rd Circuit, 1955); *Plunkett* v. *Commissioner of Internal Revenue*, 118 F. 2d 644, (1st Circuit, 1941), and *Nashville Trust Co.* v. *Commissioner of Internal Revenue*, 136 F. 2d 148 (6th Circuit, 1943).

Authority contra can be found in *Estate of Stallworth* v. *Commissioner of Internal Revenue*, 260 F. 2d 760 (5th Circuit, 1958); *Estate of Sweet* v. *Commissioner of Internal Revenue*, 234 F. 2d 401 (10th Circuit, 1956); *Pitts* v. *Hamrick*, 228 F. 2d 486 (4th Circuit, 1955); *Doll* v. *Commissioner of Internal Revenue*, 149 F. 2d 239 (8th Circuit, 1945); *Wolfsen* v. *Smyth*, 223 F. 2d 111 (9th Circuit, 1955) and *Daine* v. *Commissioner of Internal Revenue*, 168 F. 2d 449 (2nd Circuit, 1948).

A brief reference to the holding in certain of the above decisions would appear to be in order here.

In *Gallagher* v. *Smith*, *supra*, which appears to be the main case relied upon by the plaintiff, the Court qualifies the holding by stating that the State court judgment must "* * * not (be) obtained by collusion for the purpose of defeating the tax."

In the case of *Stallworth's Estate* v. *Commissioner of Internal Revenue*, *supra*, it is stated, "If the Alabama suit was non-adversary in character it is not binding," on the Federal Court.

Estate of Sweet, *supra*, held:

> "While rights and interests of parties in property are created and determined by state law, an order or judgment of a state court obtained through collusion, or attended with some other badge of fraud, or entered in a nonadversary proceeding, is not binding as between one or more parties to such proceeding and

the United States in respect to income or estate taxes imposed by federal legislation."

In the *Daine* case, *supra*, the court held "* * * it is clear that the retroactive judgments of state courts do not determine the rights of the Federal Government under its tax laws."

The only Circuit that has not been cited above on this question appears to be the Seventh.

Defendant refers us to *Merchants National Bank & Trust Company of Indianapolis v. United States*, 246 F. 2d 410 (7th Circuit, 1957), as a case wherein our Circuit held such a state court decree not binding. Our interpretation of this case does not agree with defendant's. The parties in the *Merchants National Bank* case had agreed that if the state court decision had been rendered in a non-adversary proceeding it would not be binding. The 7th Circuit Court of Appeals merely determined that the state court proceeding was nonadversary. They never passed on the question present here.

> "* * * both sides agree that, if the probate court final decree was entered by consent of the parties or in a nonadversary proceeding, it is not binding upon defendants in this federal estate tax litigation. It is, therefore, unnecessary for us to pass upon the validity of that proposition of law and we are relieved of any obligation to consider and reconcile a number of seemingly conflicting federal courts of appeals cases." *Merchants National Bank and Trust Company of Indianapolis v. United States*, *supra*, at page 417.

Through independent research, however, this Court discovered a 7th Circuit case that would seem to be in point. In *Brainard v. Commissioner of Internal Revenue*, 91 F. 2d 880, (7th Circuit, 1937), the plaintiff presented a duly authenticated decree of the Cook County Circuit Court and argued that this decree was conclusively determinative of the issue before the federal court.

The 7th Circuit, speaking through Justice Sparks, said,

> "With due deference to that court, however, we cannot accept the ruling as an expression of the judgment of the state of Illinois as to the property rights of her citizens in the interpretation of the local laws. That court's jurisdiction is limited to Cook County and there are close to a hundred other circuit courts in Illinois of equal jurisdiction which are not bound by the rulings of the Cook County Circuit Court. For the interpretation of the laws of Illinois, we must look to the decisions of the Supreme and Appellate Courts of that state, for their rulings are binding upon all the inferior courts of Illinois.
>
> It is no doubt true that the proffered decree is binding upon the parties to that suit, and it will not be appealed from, because all parties thereto are satisfied with it; but we think it cannot be binding on the government, which was not a party, and which of course has no right of appeal."

Brainard v. *Commissioner of Internal Revenue*, *supra*, at pages 883-884.

It is the opinion of this Court that the *Brainard* case and the cases cited above from the 2nd, 4th, 5th, 8th, 9th and 10th Circuits represent the better view, and, accordingly, we hold that the decree of the Steuben Circuit Court is not binding.

The above holding presents us with another issue. If the beneficiary of a testamentary trust that is to arise after a life estate in another attains the age at which he is to take the corpus before the trust comes into existence, due to the longevity of the intervening life tenant, does the trust lapse for want of a beneficiary and the property pass with the residue to the residuary legatee?

It is the plaintiff's contention that it does. As authority for this proposition, plaintiff cites *Hancock Trustee* v. *Maynard*, 72 Ind. App. 661, 126 N. E. 451, (1920); *Levering*

v. *Levering*, 88 Ind. App. 374, 162 N. E. 448, (1928); *Trustees of Presbyterian Church* v. *Katsianis*, 78 Ind. App. 406, 134 N. E. 684, (1922); *Shriver* v. *Montgomery*, 181 Ind. 108, 103 N. E. 945, (1914); *Fisher* v. *Harrison* (Va. 1935), 182 S. E. 543, 104 A. L. R. 102; *French* v. *Heywood*, (Mass. 1913), 102 N. E. 271 and *Carey* v. *White*, 126 Ind. App. 418, 126 N. E. 2d 255, (1955).

None of these cases are in point. In each of them, with the exception of *Fisher* v. *Harrison*, *supra*, the gift in trust was held to have lapsed *because of the death of the beneficiary*. That is not the case here. In *Fisher* v. *Harrison*, *supra*, the gift in trust lapsed due to the ambiguity and uncertainty of the language used and for this reason it is not in point either.

In the instant case the children had merely attained the age at which they were to take the corpus of the trust. This does not cause the trust to lapse for want of a beneficiary. At most it makes the trust "passive" or "dry," since all of the active duties of the trustees have been performed, i. e., the property withheld until the beneficiaries reached the age of 35. See *Jackson* v. *Pillsbury*, (Ill.) 44 N. E. 2d 537, (1942). No Indiana authority directly in point has been found but Indiana does recognize this principle of law. See Indiana Law Encyclopedia, Volume 28, Trusts, § 98, p. 564-65; Burns' Indiana Statutes Annotated 56-609, and *Allen* v. *Craft*, 109 Ind. 476, 9 N. E. 919, (1887).

It is clear to this court that the Will of Floyd B. Faulkerson, which was drawn on April 6, 1931, intended to create an active trust of his estate for the benefit of his two children until they should attain the age of 35 years. It is equally clear that it was the intent of Mr. Faulkerson to give only a life estate to his wife. The fact that the children attained the age of 35 years prior to testator's death in no way changed his intentions. The result of

this fact is merely to change the trust for the benefit of the children to a "passive" trust. Upon the eventual demise of his widow the property passes to the trustee for an instant only and then on to the beneficiaries. *Allen* v. *Craft, supra.*

This Court holds that the Estate of Floyd B. Faulkerson was not entitled to the marital deduction it claimed and that the Commissioner was correct when he disallowed this deduction and assessed the deficiency.

It is therefore, the considered judgment of this Court that the law is with the defendant and against the plaintiff, that plaintiff take nothing by way of his Complaint and that plaintiff bear the costs of this action.

Robert A. Grant,
Judge.

Enter: March 29, 1961.

APPENDIX B.

IN THE UNITED STATES COURT OF APPEALS.
For the Seventh Circuit.
September Term, 1961—January Session, 1962.

No. 13519
ESTATE OF FLOYD B. FAULKERSON, Deceased, BERNIECE E. FAULKERSON, Administratrix, *Plaintiff-Appellant*, *vs.* UNITED STATES OF AMERICA, *Defendant-Appellee*.

Appeal from the United States District Court for the Northern District of Indiana, Fort Wayne Division.

March 28, 1962

Before HASTINGS, *Chief Judge*, SCHNACKENBERG and KILEY, *Circuit Judges*.

HASTINGS, *Chief Judge*. Plaintiff-taxpayer, Berniece E. Faulkerson, administratrix with the will annexed of the estate of Floyd B. Faulkerson, deceased, brought this action in the district court against United States of America to recover federal estate taxes paid on her decedent's estate. Following a trial by the court, on a stipulation of facts, judgment was entered denying such refund. This appeal followed.

The errors relied on for reversal arise out of the ruling by the district court that the law it with the Government.

The facts are undisputed and may be summarized as follows:

The testator, Floyd (B.) Faulkerson, executed his will on April 6, 1931. He died testate a resident of Steuben County, Indiana on December 27, 1954. He left surviving his widow, Berniece E. Faulkerson and two children, Robert and Elizabeth, each 39 years of age at the time of his death. His widow probated the will in the Steuben Circuit Court (Indiana) and qualified as administratrix with the will annexed of his estate on February 8, 1955.

By the terms of the will, his wife was to receive a life estate in the entire estate with power to sell assets "for the purpose only of preventing loss and depreciation therein and for reinvestment;" upon her death the two children were to take the remainder interest, subject to a trust that was to terminate upon their attaining the age of 35 years. A final clause in the will left "all the rest, residue and remainder" of the estate to the wife.

On August 19, 1955, the administratrix petitioned the Steuben Circuit Court for entry of a decree that she be declared to be "the sole beneficiary under the will" of decedent and that all securities held by her in her fiduciary capacity be transferred to her individually as the widow. On the same day, the court entered such a decree. This decree was entered in an *ex parte* proceeding without notice to anyone, without appearances and without a hearing on the merits. The petition itself gives no reasons in support of the decree requested and makes *no reference* to the provisions of the will, other than to say that she is the beneficiary named in the will.

On October 20, 1955, taxpayer executed the federal estate tax return and claimed as a marital deduction one-half the value of the adjusted gross estate. This claim was subsequently disallowed by the Commissioner of Internal Revenue and a deficiency was assessed and paid in the amount of $22,972.44. In this action, taxpayer seeks a refund of this amount, with interest.

Other proceedings had in the Steuben Circuit Court were the Indiana state inheritance determination, payment of such tax and the approval of a final accounting and distribution of the assets of the estate. The actions taken were consistent with the prior decree of such court finding the widow to be the sole beneficiary under the will. These other proceedings were *ex parte* in nature, without any personal notices to or appearances by testator's two children.

In the instant case, the district court held that it was not bound by the decree of the Indiana state court determining the widow to be the sole beneficiary. It held in effect that the widow took only a life estate with the remainder in fee to the two children. As a consequence, it was determined that decedent's estate was not entitled to the claimed marital deduction and that the Commissioner was correct in his disallowance of such deduction and in assessing the deficiency. We agree with these findings and the judgment entered thereon.

We have no quarrel with the holdings in numerous Indiana decisions cited by taxpayer governing the construction of wills. Likewise, we entertain no doubt that the district court correctly determined the beneficial interests of the widow and the two children under the will in question. At the time of testator's death, the children were beyond the age fixed in the testamentary trust, and they took as *remaindermen, subject only to the life estate* in their mother, the widow.

Taxpayer contends that in any event the decree of the Steuben Circuit Court is binding on the federal court and that such decree has conclusively determined the right of taxpayer to claim the marital deduction. We do not agree.

The decree of the Steuben Circuit Court was rendered

in an *ex parte*, nonadversary proceeding, without a hearing on the merits. It reached a result contrary to Indiana law and Treasury Regulations. The decree was obtained in a proceeding that was collusive in the sense that a decision was sought which would adversely affect the Government's right to additional estate tax. The Steuben Circuit Court is one of approximately 84 such courts of equal jurisdiction in Indiana whose decisions are not binding on each other. Under all these circumstances, we hold that the district court was not bound by such decree. *Blair* v. *Commissioner*, 300 U.S. 5, 9-10 (1937); *Stallworth's Estate* v. *Commissioner of Internal Rev.*, 5 Cir., 260 F. 2d 760, 763 (1958); *In re Sweet's Estate*, 10 Cir., 234 F. 2d 401, 404 (1956), cert. denied, 352 U.S. 878; *Wolfsen* v. *Smyth*, 9 Cir., 223 F. 2d 111, 113-114 (1955); *Newman* v. *Commissioner of Internal Revenue*, 9 Cir., 222 F. 2d 131, 136 (1955); *Brainard* v. *Commissioner of Internal Revenue*, 7 Cir., 91 F. 2d 880, 883-84 (1937), appeal dismissed, 303 U. S. 665; Treasury Regulations on Estate Tax, 1954 Code, Section 20.2056(e)-2(d)(2).

On the question of the binding effect of the state court decree, we find a somewhat analogous situation in *Brainard* where we considered the construction of a trust by an Illinois circuit court as it related to the imposition of federal income taxes. In that case, 91 F. 2d at 883-84, we said:

> "Appellant, however, has presented to us a duly authenticated decree of the circuit court of Cook county, Illinois, in a case wherein this appellant filed his complaint in chancery, against his wife and mother, for the construction of this trust with respect to the question now before us. That court differs with us as to the construction and effect of appellant's declaration of trust, and his subsequent acts with respect thereto. With due deference to that court, however, we can not accept the ruling as an expression

> of the judgment of the state of Illinois as to the property rights of her citizens in the interpretation of the local laws. That court's jurisdiction is limited to Cook county, and there are close to a hundred other circuit courts in Illinois of equal jurisdiction which are not bound by the rulings of the Cook county circuit court. For the interpretation of the laws of Illinois, we must look to the decisions of the Supreme and Appellate Courts of that state, for their rulings are binding upon all the inferior courts of Illinois.
>
> "It is no doubt true that the proffered decree is binding upon the parties to that suit, and it will not be appealed from, because all parties thereto are satisfied with it; but we think it can not be binding on the government, which was not a party, and which of course has no right of appeal."

In a recent decision, concerning the assessment of a federal estate tax deficiency, we passed on the character of a state court proceeding in which a decree was entered. On a statement of facts far more favorable to taxpayer than in the case at bar, we found that the decree was entered in an undefended and nonadversary proceeding and was not binding on the federal court. It is interesting to note that the parties had *agreed* that "if the probate court final decree was entered by consent of the parties or in a nonadversary proceeding, it is not binding upon [United States] in this federal estate tax litigation." *Merchants National Bank & Trust Co.* v. *United States*, 7 Cir., 246 F. 2d 410, 417 (1957), cert. denied, 355 U. S. 881.

We do not say that in a proper case—where the state court proceeding was adversary and not *ex parte;* where a hearing was had on the merits; where the question of law has been settled by the appellate courts of the state or where the judgment of an intermediate court may be fairly accepted as evidencing the law of the state; and where the judgment is not collusive—a federal court

should not be bound by the determination of property rights in the state courts. See *Morgan* v. *Commissioner*, 309 U.S. 78 (1940); *Helvering* v. *Bullard*, 303 U.S. 297 (1938); *Blair* v. *Commissioner*, 300 U.S. 5 (1937); *Freuler* v. *Helvering*, 291 U.S. 35 (1934); *Duling* v. *Markan*, 7 Cir., 231 F. 2d 833 (1956), cert. denied, 352 U.S. 870; *Pitts* v. *Hamrick*, 4 Cir., 228 F. 2d 486 (1955); *Gallagher* v. *Smith*, 3 Cir., 223 F. 2d 218 (1955).

Decedent executed his will in 1931 and died in 1954. In 1948, the Congress first created the marital deduction to be used in computing the net estate for federal estate tax purposes. As is often the case, this testator did not revise his will to enable his estate to gain the tax advantage given by the marital deduction.

In sum, we conclude that the district court properly construed testator's will under Indiana law, properly refused to be bound by the decree of the Steuben Circuit Court and properly held that decedent's estate was not entitled to the marital deduction for federal estate tax purposes.

The judgment of the district court is affirmed.

AFFIRMED.

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 275

ESTATE OF FLOYD B. FAULKERSON, DECEASED, BERNIECE E. FAULKERSON, ADMINISTRATRIX, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. 11–16) is reported at 193 F. Supp. 410. The opinion of the court of appeals (Pet. 17–22) is reported at 301 F. 2d 231.

JURISDICTION

The judgment of the court of appeals was entered on March 28, 1962. A petition for rehearing was denied on April 26, 1962. The petition for a writ of certiorari was filed on July 25, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

A decedent's will in terms gave his widow a life estate with remainders to his two adult children. On a petition filed by the widow-administratrix and unopposed by the children, however, the county probate court entered an order directing distribution of the property in fee to the widow "as the sole beneficiary". The question is whether the probate court's "construction" of the will as giving the widow a fee interest rather than a life estate is binding upon the United States to establish the right of the estate to a marital deduction under § 2056 of the Internal Revenue Code of 1954.

STATEMENT

1. Floyd Faulkerson died on December 27, 1954, being survived by his wife and two children, each aged 39. His will, after providing for the payment of debts and expenses, provided in part:

> Item II. Subject to Item I, I hereby give, devise and bequeath to my wife, Berniece E. Faulkerson, if she survives me, the use, income, rents and profits of my entire estate for and during her life, together with the power to sell any of the assets comprising my estate, consisting principally of Trust Shares, First Mortgage Bonds, Stocks and Real Estate, for the purpose only of preventing loss and depreciation therein and for reinvestment.
>
> Item III. Subject to the preceding items, I hereby give, devise and bequeath all the rest, residue and remainder of my estate of whatsoever kind or character from and after the death of my wife, Berniece E. Faulkerson, to

> the Lincoln National Bank and Trust Company of Fort Wayne, Indiana, to be held in trust by it for the use and benefit of my children, Robert Faulkerson and Elizabeth Faulkerson, equally, until they shall attain the age of thirty-five years. The said Lincoln National Bank and Trust Company, as trustee, shall collect and receive all rents, profits, and income from said estate and shall pay the same to the said beneficiaries hereunder equally, for and during the terms of years above set forth. And at the time that said children respectively reach the age of thirty-five years, the said trustee shall turn over, assign and transfer to said child so reaching said age, his or her one-half interest in the principal of said trust fund, the balance to be held in trust until said other child shall be entitled thereto under the terms of this will. * * *

The decedent's widow, the petitioner here, offered the will for probate in the Steuben Circuit Court, Steuben County, Indiana, and duly qualified as administratrix of the estate.

On August 19, 1955, the petitioner filed a petition with the Steuben Circuit Court praying, without explanation or reference to the terms of the will, that the securities belonging to the estate "be transferred to her as the sole beneficiary under the will" (G.R.[1] 9). On the same day, the court entered an order reading in part as follows (G.R. 10–11):

> * * * the court having seen and inspected said petition finds that Berniece E. Faulkerson is

[1] "G.R." refers to the appendix to the government's (appellee's) brief in the court of appeals.

> the sole beneficiary under the Will of Floyd B. Faulkerson * * *.
>
> It is, therefore, ordered, adjudged and decreed by the court that the following stocks should be transferred into the name of Berniece E. Faulkerson as the sole beneficiary under the Will of Floyd B. Faulkerson * * *.

After further intervening proceedings (relating to payment of taxes, *etc.*), the petitioner filed a final account reciting that the "Entire residue of Estate goes to [the petitioner] * * * under the Last Will and Testament" and requesting authority to make such distribution (G.R. 18). On January 13, 1956, an order was entered approving the final account and authorizing distribution pursuant to it; the petitioner filed a supplemental report reciting that the entire residuary estate had been distributed to herself "as sole beneficiary under said Will"; and the court entered an order approving the supplemental report and discharging the petitioner of any further duties as administratrix (G.R. 19–22).

The two children of the decedent had notice of the proceedings in the Steuben Circuit Court but entered no appearance and did not contest the distributions proposed by the petitioner and approved by the court (Pet. 3).

2. In filing the federal estate tax return, the petitioner deducted one-half of the adjusted gross estate as a marital deduction under § 2056 of the Internal Revenue Code of 1954. The Commissioner disallowed the deduction and petitioner, after paying the resulting deficiency, brought this suit for refund. The Court of Appeals for the Seventh Circuit, affirming

the district court, held that there passed to the petitioner under the decedent's will only a life estate which, being a terminable interest, did not qualify for the marital deduction. In rejecting the petitioner's contention that the probate court's orders constituted a binding determination that the will gave her a fee interest rather than a life estate, the court said (Pet. 19–20):

> The decree of the Steuben Circuit Court was rendered in an *ex parte*, nonadversary proceeding, without a hearing on the merits. It reached a result contrary to Indiana law and Treasury Regulations. The decree was obtained in a proceeding that was collusive in the sense that a decision was sought which would adversely affect the Government's right to additional estate tax. The Steuben Circuit Court is one of approximately 84 such courts of equal jurisdiction in Indiana whose decisions are not binding on each other. Under all these circumstances, we hold that the district court was not bound by such decree. * * *

ARGUMENT

A close examination of the facts of *Gallagher* v. *Smith*, 223 F. 2d 218 (C.A. 3), lends support to petitioner's claim that the result reached on one aspect of that case is in conflict with the result reached below. The principles stated by the Third Circuit in its opinion, however, seem on their face to be fully consistent with those applied in this case, and whether the difference in result is attributable merely to a mistaken application of those principles to the particular facts or to a basic difference of approach remains uncer-

tain. Accordingly, while there are indications that there is a developing conflict between the circuits, it has not in our view matured to a point requiring review by this Court. And while the issue is of substantial importance even apart from the existence of a conflict, its resolution by this Court can profitably await further clarifying developments in the lower courts.

1. If the necessary distinction be made between a court's "decree" (its exertion of judicial power to prescribe or command what the rights of the parties shall be) and its "decision" of issues of fact or law upon which the issuance of the decree is based, we have no disagreement with petitioner over the effect to be given to State court *decrees* for tax purposes. Assuming the decree is final and binding as a matter of State law (*i.e.*, is not subject to being set aside or modified on collateral attack) it is itself an operative event creating and fixing the rights of the parties from and after its entry. It equally has that effect, moreover, whether its entry be based upon a resolution of contested issues of law or fact or merely upon the unanimous consent of all interested parties, or whether, if the former, the decision be "right" or "wrong" as a matter of principle. If, then, the Internal Revenue Code makes a tax consequence turn solely upon the property rights existent after the entry of a decree, the decree fixing those rights, being entitled to full faith and credit, is necessarily controlling without regard to whether it was entered with

the consent of the parties or as a result of an adversary proceeding.[2]

While the petitioner fails to make the distinction, her contention depends, not upon giving binding effect merely to the State court's *decree,* but upon the federal government's being bound also by the State court's *reasoning upon a question of law* as the purported basis for entering the decree. The decree or "command" of the State court here was that the widow have henceforth absolute ownership of all the property of the estate, and we acknowledge that, from and after the entry of the decree, the widow must be treated as the full and absolute owner of the property for federal tax purposes as well as for all other purposes.[3] That, however, does not answer the question upon which the tax consequences in this case turn, which is, not whether the widow now owns the property, but whether she acquired it by virtue of rights of descent from the decedent (here, under the will).

Section 2056 allows a marital deduction only for a nonterminable "interest in property which passes * * * from the decedent to his surviving spouse."

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[2] For example, the taxability of income from property normally depends solely upon who owns the property at the time the income is produced, regardless of how he came to own it. Thus a decree awarding property to a person will automatically determine the taxability of the income thereafter produced by the property regardless of how "wrong" the decree may have been as a matter of principle or whether it was based on the consent of the parties.

[3] As a result of the binding effect of the decree, for example, the property will be includible in her estate for estate tax purposes.

If the widow had clearly been given under the terms of the will only a life estate; if the remaindermen had nevertheless expressly consented to, and urged the State court to enter, a decree foreclosing their rights and giving the widow instead a fee simple estate; and if the State court had entered such a decree expressly on the basis of the parties' consent, the decree would have had the same effect but the estate, equally plainly, would not have been entitled to a marital deduction. The widow would have received a fee interest but she would have received it, not because the will gave it to her, but by virtue of what amounts to a "gift" from the remaindermen; the fee interest would not have "passed" to her "from the decedent" and would thus not have qualified for the marital deduction.

The part of the State court's action upon which the petitioner must rely, accordingly, is not the *decree* as such but the underlying *reasoning*, upon which the decree was purportedly based, construing the will as devising to the widow a fee interest rather than merely a life estate. The question, in short, is not one of the effect to be given to a State court's decree but of the effect to be given to its resolution of the underlying issues of law or fact upon which the decree purports to be grounded.

2. On that issue, the petitioner asserts a conflict with the decision of the Third Circuit in *Gallagher* v. *Smith*, 223 F. 2d 218. The recent decisions of the Third Circuit do reveal, we think, an underlying difference in principle between that court and other courts of appeals—including the Seventh Circuit's

decision in this case—in the effect given to decisions of State courts in uncontested proceedings, and we would welcome clarification of the question by this Court. As yet, however, we do not believe that there is such a square conflict of actual holdings as to require review by this Court.

In the *Gallagher* case, a decedent dying in 1942 devised property in trust to pay the income to his widow for life and then to distribute the property to his twelve children. A spendthrift provision directed that the corpus and income were to be free of "all debts, contracts, transfers, hypothecations and anticipations of my wife or children." The widow purported to renounce and disclaim any interest given her by the will except for a one-thirteenth interest in the income,[4] with the consequence that, in 1943 and subsequent years, twelve-thirteenths of the income was distributed to and reported as income by the twelve children who, as remaindermen, would succeed to that interest if it had been effectively renounced. In June 1948, the probate court, reviewing the trustee's account, approved the past disbursement of income to the children and awarded the remaining undistributed income in equal shares to the widow and the children, noting that the widow had a right to disclaim or renounce her interest (as distinguished from assigning or pledging it) notwithstanding the spendthrift provision.

In a suit involving the taxable years 1943 through 1948, the Commissioner contended that the purported

[4] A written "Confirmation of Release and Disclaimer" was not executed until 1947, but it apparently purported to confirm an oral renunciation made in 1943.

disclaimer was ineffective under the spendthrift provision; that it operated only as a revocable direction to the trustee to distribute the income to the children; and that all of the income accordingly remained taxable to the widow. In considering the effect to be given to the State court proceedings, the Third Circuit's opinion on its face seems to make the very distinction we have suggested between (1) a State court's "determination of some * * * question of law or fact asserted to be involved in the federal tax case"—which "it is perfectly clear * * * cannot be res judicata against the United States" since it was not a party (p. 222)—and (2) an "adjudication of * * * a question of title" which "is conclusive of the parties' property rights" (p. 223)—which necessarily controls any tax question which depends solely upon "the person entitled to the income or other property under the state law" (p. 222). Applying that distinction to the facts of *Gallagher*, the result logically should have been that the State decree was conclusive of the taxability of the trust income accruing during the last half of 1948 (*i.e.*, following the decree) but not of that for the period from 1943 through the first half of 1948. In terms of the operative effect of the probate court's *decree* upon the property rights of the parties, the most it could have done was (1) to fix the children's rights thereafter to receive the income and (2) to release the trustee from liability for any prior disbursements and to preclude the widow from recovering any of the moneys that had been paid to the children. The first, we agree, would control the taxability of the future income of the trust, since the

Internal Revenue Code makes ownership of the income interest, however acquired, the determinant of taxability. The second consequence, however, does not determine the taxability of the prior income of the trust, since those consequences would follow even if the purported renunciation had remained revocable until the decree was entered (see p. 227, n. 2), and the Internal Revenue Code makes taxability turn upon whether a purported transfer of an income interest is revocable or irrevocable prior to the actual payment, quite apart from the ability to recover the payment once made. The part of the State court's action relevant to the taxability of the pre-1948 income, therefore, was not the judgment or decree itself, but the court's "determination" of a "question of fact or law" preliminary to the entry of the decree—namely, whether in fact the widow had attempted to renounce her interest and whether in law she had had the capacity to do so. Under the Third Circuit's own rationale, therefore, it should have held the State court's action conclusive only as to the last six months of the six-year period involved. Had it done so, there would, in turn, have been no basis for a claim of conflict in this case.

The difficulty is that the Third Circuit, despite what seems to us the clear meaning of its articulated rationale, in fact treated the State court proceedings as conclusive of the tax question for the entire six-year period. It thus actually gave conclusive effect, not only to the *decree* creating and fixing property rights prospectively, but also to the *decision* of the questions of law or fact governing the effect under

State law of the purported disclaimer in 1943. Looking only at what the court *did*, therefore, there does seem to be a conflict of decisions.[5] If, however, the discrepancy between what the court said and what it did was attributable only to a failure of proper analysis of the facts before it and an inadvertent misapplication of principles themselves unexceptionable, there is not, we submit, the kind of conflict that requires immediate resolution by this Court.

We acknowledge that subsequent decisions of the Third Circuit would suggest that the principles actually being followed by that court are closer to what it did in *Gallagher* than to what it said, but those decisions are not themselves in any more direct conflict with this case than is *Gallagher*[6] and the principles of law adhered to by that court remain ambiguous. Under the circumstances, the appropriate course, we suggest, is to await clarification of the Third Circuit's

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[5] Unless of course a further distinction can be found in the "quality" of the State courts' consideration of the issues in the two cases. Compare 223 F. 2d at 224 (discussion of the *Childs' Estate* case) and 226 with the nature of the State proceedings in this case, and see note 7, *infra*.

[6] *Estate of Darlington* v. *Commissioner*, 302 F. 2d 693, and *Estate of Babcock* v. *Commissioner*, 234 F. 2d 837, can be read as being based upon a construction of the relevant provision of the Internal Revenue Code as making the operative effect of the State *decree* determinative regardless of the grounds upon which it was based. In *Beecher* v. *United States*, 280 F. 2d 202, the court based its decision alternatively upon its own reading of State law.

position in further litigation before review is undertaken by this Court.[1]

[1] The *Gallagher* case held the State court action conclusively binding as a matter of full faith and credit, and the claim of conflict in this case goes to the failure of the court below to afford similarly conclusive "credit" to the State court's decision here. The discussion in this brief has, accordingly, been limited to the extent to which State court action commands full faith and credit, and it is for that purpose that we have emphasized the dichotomy between a court's *decree* and its *decision* of the underlying issues of fact or law. In dealing with the claim of conflict in its own terms, however, we do not mean to imply that full faith and credit is the only basis upon which respect might be given to a State court's action. A State court's resolution of issues of fact or law, even though not having the imperative force of its resulting decree, might nevertheless be entitled to be accepted by federal tax tribunals simply as a matter of comity or sound principles of federalism. See *Blair v. Commissioner*, 300 U.S. 5. The extent to which the United States should be required to abide the resolution of issues in proceedings to which it is not a party as a matter of comity would depend, however, not upon the absolutes of the *Gallagher* case or of full faith or credit, but upon a pragmatic judgment taking into account such factors as the adversary or nonadversary character of the proceedings; the decision's consistency with other authoritative declarations of State law; the extent to which the court actually considered the issues on the merits; the rank of the court in the State's judicial hierarchy; and the extent to which the decision had significant non-tax consequences. However the line is ultimately to be drawn—an admittedly difficult question—under no principle of comity could the United States be bound by a mere formal recital, as in this case, contained in a probate court's order of distribution entered upon the administratrix' unopposed petition without hearing, briefs, or even acknowledgment of the issue. It is for that reason that the petitioner here must rely, not upon the more fluid principles of comity, but upon the absolutes of the *Gallagher* case and its apparent misapplication of full faith and credit principles.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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